

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

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IN RE:

T.R.A. DOCKET ROOM

PETITION OF TENNESSEE-AMERICAN
WATER COMPANY TO CHANGE AND
INCREASE CERTAIN RATES AND
CHARGES SO AS TO PERMIT IT TO EARN A
FAIR AND ADEQUATE RATE OF RETURN
ON ITS PROPERTY USED AND USEFUL IN
FURNISHING WATER SERVICE TO ITS
CUSTOMERS

DOCKET NO. 04-00288

PROPOSED SETTLEMENT AGREEMENT

For the sole purpose of settling the case of Petition of Tennessee-American Water Company to Change and Increase Certain Rates and Charges So as to Permit It to Earn a Fair and Adequate Rate of Return on its Property Used and Useful in Furnishing Water Service to its Customers, TRA Docket No. 04-00288, the Office of Attorney General through the Consumer Advocate and Protection Division ("Attorney General"), the City of Chattanooga ("City"), the Chattanooga Manufacturers Association ("CMA"), and Tennessee-American Water Company ("Tennessee-American") (collectively, the "Parties") hereby agree and stipulate as follows in the above-styled case set for hearing on January 31, 2005:

1. The Parties stipulate and agree that Tennessee-American is entitled to earn a 7.76% return on investments with a 9.9% return on equity, as shown in attached Schedule 9.
2. The Parties further stipulate and agree that a 7.76% return on investment generates a revenue deficiency of \$297,005. The revenue deficiency is shown in attached Schedule 1

3. The Parties further stipulate and agree that Tennessee-American shall withdraw its request for the "Low Income Tariff" as referenced and described in paragraph 13 of its Petition.

4. The Parties further stipulate and agree that Tennessee-American shall measure and report service metrics as summarized in attached Schedule 10.


5. The Parties further stipulate and agree that the increase in rates attributable to the revenue deficiency of \$297,005 shall be allocated to all classes of customers in an across-the-board percentage increase of 0.93% to the metered tariffs, as shown in attached Schedule 11.


6. In light of the General Assembly's enactment of Tenn. Code Ann. § 65-5-101(d) (2004) prohibiting privately-owned water utilities from charging municipal governments for fire hydrant service, the Parties further stipulate and agree that public fire hydrant service charges of \$897,285 approved by the Tennessee Regulatory Authority ("TRA") in TRA Docket No. 03-00118 to be allocated to municipal governments shall be allocated to all classes of customers in an across-the-board percentage increase of 2.90% to the metered tariffs, as shown in attached Schedule 11.

7. The Parties further stipulate and agree that Tennessee-American shall submit with its next rate case petition a cost of service study in the same form as that submitted by Dr. Herbert in Tennessee-American's last rate case, TRA Docket No. 03-00118. The Parties further stipulate and agree that in any future proceeding each Party reserves its right to proffer its own testimony and evidence regarding the sufficiency, conclusions, weight and relevancy of such cost of service study

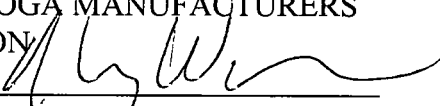
8. In the event that the TRA does not accept the Proposed Settlement in whole or in part, the Parties are not bound by any position set forth herein.

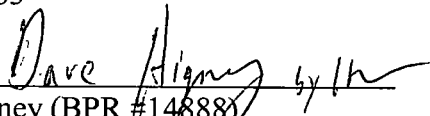
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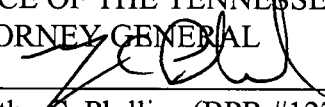
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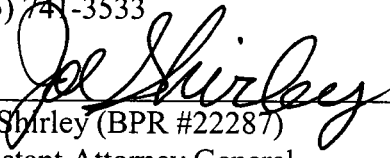
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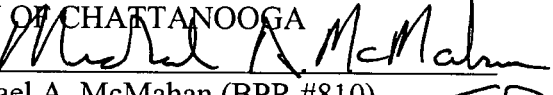
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Dated: February 3, 2005

CERTIFICATE OF SERVICE


I hereby certify that a true and exact copy of the foregoing has been forwarded by facsimile and/or first-class mail, postage prepaid on February 4th, 2005, to the following:

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Tennessee-American Water
Index to Schedules
For the 12 Months Ending December 31, 2005

	<u>Schedule No.</u>
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Tennessee-American Water
Revenue Deficiency
For the 12 Months Ending December 31, 2005

Line No		CAPD		Company		Difference
1	Rate Base	87,611,390	A/	87,611,390	A/	-
2	Operating Income at Present Rates	6,616,813	B/	5,846,425	B/	770,388
3	Earned Rate of Return (Line 2/Line 1)	7.55%		6.67%		0.88%
4	Cost of Capital	7.76%	C/	7.997%	E/	-0.24%
5	Required Operating Income (Line 1*Line 4)	6,798,644		7,006,283		(207,639)
6	Operating Income Deficiency (Line 5-Line 2)	181,830		1,159,858		(978,027)
7	Gross Revenue Conversion Factor	1.633418	D/	1.69890763	E/	(0.065490)
8	Revenue Deficiency (Line 6*Line 7)	297,005		1,970,491		(1,673,486)

A/ Schedule 2

B/ Schedule 3

C/ Schedule 9

D/ Schedule 8

E/ Diskin REVISED Exhibit 1, Schedule 1

Tennessee-American Water
Comparative Rate Base
For the 12 Months Ending December 31, 2005

Line No.		CAPD	A/	Company	A/	Difference
1	Utility Plant in Service	160,157,718		160,157,718		-
2	Construction Work in Progress	801,659		801,659		-
3	Utility Plant Capital Lease	1,590,500		1,590,500		-
4	Limited-Term Utility Plant - Net	(3,270)		(3,270)		-
5	Working Capital	1,385,205		1,385,205		-
6	Def Maint	5,641		5,641		-
7	Total Additions	163,937,453		163,937,453		-
8	Accumulated Depreciation	51,928,414		51,928,414		-
9	Accumulated Amort of Utility Capital Lease	742,234		742,234		-
10	Accumulated Deferred Income Taxes	13,486,419		13,486,419		-
11	Customer Advances for Construction	2,432,851		2,432,851		-
12	Contributions In Aid of Construction	7,765,092		7,765,092		-
13	Unamortized Investment Tax Credit	45,733		45,733		-
14	RWIP	(74,680)		(74,680)		-
15	Total Deductions	76,326,063		76,326,063		-
16	Rate Base	87,611,390		87,611,390		-

A/ Company Exhibit 1, Sch. 2

Tennessee-American Water
Income Statement at Current Rates
For the 12 Months Ending December 31, 2005

Line No		CAPD		Company		Difference
1	Operating Revenues	33,057,417	A/	33,057,417	A/	-
2	Operations and Maintenance Expense	16,262,091	B/	16,709,359	B/	(447,268)
3	Depreciation and Amortization Expense	4,558,016	C/	4,558,016	C/	-
4	Taxes Other Than Income	3,314,870	D/	3,456,977	G/	(142,107)
5	State Excise Tax	170,901	E/	378,505	H/	(207,604)
6	Federal Income Tax	2,163,517	E/	2,136,926	H/	26,591
7	Total Operating Expense	26,469,395		27,239,783		(770,388)
8	AFUDC	28,791	F/	28,791	F/	-
9	Net Operating Income for Return	6,616,813		5,846,425		770,388

A/ Company Exhibit 2, Sch. 2

B/ Schedule 5

C/ Company Exhibit 2, Sch. 1

D/ Schedule 6

E/ Schedule 7

F/ Company Exhibit 2, Sch. 3

G/ Company Exhibit 2, Sch. 1, but does not tie to Company's supporting workpapers (See Sch. 6)

H/ Company Exhibit 2, Sch. 6

Tennessee-American Water
Income Statement at Proposed Rates
For the 12 Months Ending December 31, 2005

Line No		Current Rates	A/ B/	Adjustments	C/ Proposed Rates
1	Operating Revenues	32,522,732	B/	297,005	32,819,737
2	Forfeited Discount Revenues	534,685	B/	4,990	539,675
3	Total Revenues	<u>33,057,417</u>		<u>301,995</u>	<u>33,359,412</u>
4	Operations and Maintenance Expense	16,262,091		2,809	16,264,900
5	Depreciation and Amortization Expense	4,558,016			4,558,016
6	Taxes Other Than Income	3,314,870			3,314,870
7	State Excise Tax	170,901		19,447	190,348
8	Federal Income Tax	<u>2,163,517</u>		97,909	<u>2,261,425</u>
9	Total Operating Expense	<u>26,469,395</u>			<u>26,589,559</u>
10	AFUDC	<u>28,791</u>			<u>28,791</u>
11	Net Operating Income for Return	<u>6,616,813</u>			<u>6,798,644</u>

A/ Schedule 3

B/ Company Exhibit 2, Sch 2

C/ Schedule 1, Line 8 x appropriate factor from Schedule 8

Tennessee-American Water
Operation & Maintenance Expenses
For the 12 Months Ending December 31, 2005

Line No		CAPD	A/	Company	B/	Difference
1	Salaries and Wages	4,082,080		4,383,883		(301,803)
2	Purchased Water	26,148		15,330		10,818
3	Fuel and Power	1,650,433		1,755,680		(105,247)
4	Chemicals	861,861		861,861		-
5	Waste Disposal	118,201		133,438		(15,237)
6	Management Fees	3,219,932		3,062,940		156,992
7	Group Insurance	1,339,248		1,386,004		(46,756)
8	Pensions	829,731		892,790		(63,059)
9	Regulatory Expense	58,000		58,000		-
10	Insurance Other Than Group	673,430		657,000		16,430
11	Customer Accounting	570,625		572,893		(2,268)
12	Uncollectible Expense	289,530		289,530		-
13	Rents	37,888		38,286		(398)
14	General Office Expense	208,057		193,122		14,935
15	Miscellaneous Expense	1,715,487		1,661,970		53,517
16	Other Maintenance Expense	<u>581,440</u>		<u>746,632</u>		<u>(165,192)</u>
17	Total O&M Expense	<u>16,262,091</u>		<u>16,709,359</u>		<u>(447,268)</u>

A/ CAPD Workpapers

B/ Company Exhibit 2, Sch 3

Tennessee-American Water
Taxes Other Than Income Taxes
For the 12 Months Ending December 31, 2005

Line No		CAPD		Company	D/ Difference
1	Other General Taxes	900		900	-
2	Gross Receipts Tax	356,815	A/	566,595	(209,780)
3	TRA Inspection Fee	59,413		59,413	-
4	Property Taxes	2,300,000	B/	2,503,629	(203,629)
5	Franchise Tax	259,938		259,938	-
6	FICA Taxes	332,999	C/	332,999	-
7	Unemployment Taxes	4,805	C/	4,805	-
8	Total Taxes Other Than Income Taxes	<u>3,314,870</u>		<u>3,728,279</u>	<u>(413,409)</u>

A/ CAPD Workpaper T-OTAX2

B/ CAPD Workpaper T-OTAX1

C/ CAPD Workpaper T-OTAX3

D/ Company Exhibit 2, Sch 5 adjusted by Company Response to CAPD Data Request #17

Tennessee-American Water
Excise and Income Taxes
For the 12 Months Ending December 31, 2005

Line No		Attrition Amount A/ B/
1	Operating Revenues	33,057,417 B/
2	Salaries and Wages	4,082,080
3	Purchased Water	26,148
4	Fuel and Power	1,650,433
5	Chemicals	861,861
6	Waste Disposal	118,201
7	Service Company Charges	3,219,932
8	Group Insurance	1,339,248
9	Pensions	829,731
10	Regulatory Expense	58,000
11	Insurance Other Than Group	673,430
12	Customer Accounting	570,625
13	Uncollectible Expense	289,530
14	Rents	37,888
15	General Office Expense	208,057
16	Miscellaneous Expense	1,715,487
17	Other Maintenance Expense	581,440
18	Depreciation and Amortization Expense	4,558,016
19	Taxes Other Than Income	3,314,870
20	NOI Before Excise and Income Taxes	8,922,440
21	AFUDC	28,791
22	Interest Expense	(3,200,900) C/
23	Pre-tax Book Income	5,750,331
24	Schedule M Adjustments	(4,479,690) D/
25	Excise Taxable Income	1,270,641
26	Excise Tax Rate	6 50%
27	Excise Tax Payable	82,592
28	Excise Tax Deferred	88,309
29	Excise Tax Expense	170,901
30	Pre-tax Book Income	5,750,331
31	Preferred Dividend Credit	(28,824) E/
32	Excise Tax	(170,901)
33	Schedule M Adjustments	(4,479,690) D/
34	FIT Taxable Income	1,070,917
35	FIT Rate	35 00%
36	Federal Income Tax Payable	374,821
37	ITC Amortization	(76,368)
38	Federal Income Tax Deferred	1,865,064
39	Federal Income Tax Expense	2,163,517

A/ Schedule 5

B/ Schedule 4

C/ Schedule 1, line 1 * Weighted Cost of Debt per Schedule 9

D/ This is the net difference of the Permanent Differences of \$2,950 and the Temporary Differences of \$4,482,640 shown on E/

E/ Exhibit No 2, Schedule 6, Page 2 of 2

Tennessee-American Water
Revenue Conversion Factor
For the 12 Months Ending December 31, 2005

Line No.		<u>Amount</u>	<u>Balance</u>
1	Operating Revenues		1 000000
2	Add. Forfeited Discounts	0 0168 A/	<u>0 016800</u>
3	Balance		1 016800
4	Uncollectible Ratio	0 0093 B/	<u>0 009456</u>
5	Balance		1 007344
6	State Excise Tax	0 0650 C/	<u>0 065477</u>
7	Balance		0 941866
8	Federal Income Tax	0 3500 C/	<u>0 329653</u>
9	Balance		<u>0 612213</u>
10	Revenue Conversion Factor (Line 1 / Line 11)		<u><u>1 633418</u></u>

A/ Company Exhibit 2, Sch. 2 (\$534,685/\$31,840,192)

B/ Company Workpapers

C/ Statutory Rate

Tennessee-American Water
Cost of Capital
For the 12 Months Ending December 31, 2005

Line No.	Parent	Ratio	Cost	Weighted Cost	Tax Deductible
1	Short Term Debt	6 30%	2 40%	0 15%	0 12%
2	Long Term Debt	42 30%	6 00%	2 54%	2 05%
3	Preferred Equity	0 30%	5 00%	0.02%	
4	Common Equity	51 10%	9 90%	5 06%	
5	Total	<u>100 00%</u>		<u>7.77%</u>	
	<u>Tennessee American</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>	
6	Short Term Debt	0 00%	0 00%	0 00%	
7	Long Term Debt	19 20%	7 71%	1 48%	1 48%
8	Common Equity	80.80%	7 77%	6 28%	
9	Total	<u>100 00%</u>		<u>7.76%</u>	<u>3.65%</u>
Final Capital Structure					
	<u>Parent</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>	<u>Tax Deductible</u>
10	Short Term Debt	5 09%	2 40%	0 12%	0.12%
11	Long Term Debt	34 18%	6 00%	2 05%	2.05%
12	Preferred Equity	0 24%	5 00%	0 01%	
13	Common Equity	41 29%	9 90%	4 09%	
	Total Parent	80 80%	7.76%	6 27%	
	<u>Tennessee American</u>				
14	Short Term Debt	0 00%	0 00%	0 00%	0 00%
15	Long Term Debt	19 20%	7 71%	1 48%	1.48%
16	Total Subsidiary	19 20%	7.71%	1 48%	
17	Total	<u>100 00%</u>		<u>7.75%</u>	<u>3.65%</u>

Source Exhibit CAPD-SB, Schedules 37 and 38

TENNESSEE AMERICAN WATER COMPANY
Settlement Agreement Regarding Service Metrics and Reporting
TRA Docket # 04-00288
January 27, 2005
SCHEDULE 10

Customer Service - Call Center:

1. Begin Reporting Monthly Customer Care Scorecard (as identified in Mike Miller's Rebuttal Testimony) on a monthly basis and reporting to the Tennessee Regulatory Authority (TRA), the CAPD by March 1, 2005.
2. Develop similar Monthly Customer Care Scorecard with "Tennessee Specific" Statistics reporting by January 1, 2006 to TRA and CAPD. TAWC is not currently able to measure dropped calls from TN ratepayers, but will work with the Consumer Advocate toward establishing the necessary mechanisms to measure dropped calls, if practicable.

Tennessee Local Operations:

3. TAWC Employee Reporting by job title with its quarterly reporting to the TRA including allocated Tennessee specific Call Center employees.
4. Field Service (Tennessee Office) - Monthly Reporting To TRA and CAPD by March 1, 2005
 - A. Service Orders Worked - Monthly
 - B. Appointment Orders - % on-time
 - C. Appointments Missed
 - D. Meter Reading
 - a. Total meters
 - b. Meters read
 - c. Estimates
 - d. % Estimated
 - e. Number of Meters not billed 3 months, 6 months, 12 months

Customer Surveys:

5. Customer Survey Responses Reported To TRA and CAPD On A Quarterly Basis beginning 2005) detailed by affiliate:
 - A. Satisfaction in Reaching American Water Call Center
 - B. Satisfaction with Call Center Operation Problem Resolution
 - C. Satisfaction with company response for service
 - D. Satisfaction with water quality

	A/ Present	Fire Hydrant Shift	Post Shift	%	Increase	%	Total
Residential	\$ 13,302,692	\$ 385,753	\$ 13,688,445	2.90%	\$ 127,686	0.93%	\$ 13,816,131
Commercial	9,464,969	274,466	9,739,435	2.90%	90,849	0.93%	9,830,285
Industrial	3,399,370	98,575	3,497,945	2.90%	32,629	0.93%	3,530,574
Other Public Authority	2,500,771	72,518	2,573,289	2.90%	24,004	0.93%	2,597,292
Sales for Resale	920,714	26,699	947,413	2.90%	8,837	0.93%	956,250
Private Fire	1,354,352	39,274	1,393,626	2.90%	13,000	0.93%	1,406,625
Public Fire	897,285	(897,285)	-	-100.00%	-	0.00%	-
Total	\$ 31,840,153	\$ -	\$ 31,840,153	0.00%	\$ 297,005	0.93%	\$ 32,137,158

A/ TAWC witness Herbert Exhibit.